Default on Foreign Sovereign Debt: A Question for the Courts?

I. INTRODUCTION

In the 1980's foreign sovereign debt has emerged as a major international crisis.¹ Never before has sovereign debt owed to commercial banks risen to such a precarious level.² The current inability of a number of foreign sovereign debtors to service adequately their debt obligations³ threatens the stability of both the international monetary system and the American banking system.⁴ Debt rescheduling⁵ has alleviated the crisis at this stage, yet actual repayment of the debt has only been delayed.⁶

¹This is debt incurred by governments or their instrumentalities, particularly the governments of the lesser developed countries. These countries also use government-controlled entities to channel external credits to the private sector. See Reisner, Default By Foreign Sovereign Debtors: An Introductory Perspective, 1982 U. ILL. L. REV. 1 (1982).


³The 1983 report of the World Bank states that "[m]ost indicators of credit-worthiness showed a serious decline in the ability of developing countries to [pay interest on] their debt." Developing Countries' Economies Suffered in '83, World Bank Says, The Indianapolis Star, Sept. 17, 1984, at 15, col. 3. According to reports of the International Monetary Fund, thirty-two countries were in arrears in 1981, as compared to fifteen in 1975. See Comment, International Debt, supra note 2, at 855 n.7.

⁴Internationally, conflict could result between the capital importing and the capital exporting countries. Declaration of default against one country could create a domino effect, causing other states to default. Barnett, Galvis & Gouraige, supra note 2, at 113.

Démostically, an avalanche of defaults, particularly by the major borrowers, could render a number of American banks insolvent. As of June 30, 1980, the debt exposure of the nine largest U.S. banks to the lesser developed countries represented more than 200% of their capital reserves, and the comparable figure for the next fifty largest banks was over 100%. Dod, Bank Lending in Developing Countries, 67 FED. RESERVE BULL. 647, 655 (1981).

⁵In a debt rescheduling, the payments under the original obligation are stretched over a longer period. The banks have also extended additional credits to help borrowers overcome short-term liquidity problems. Barnett, Galvis & Gouraige, supra note 2, at 84.

⁶As reported by the World Bank, resolution of the liquidity crisis of the early 1980's was achieved through maintenance of the terms on which the debt was originally contracted. Agreements to reschedule have merely pushed back the timetable for payment on the loan principal and have increased the total debt obligations. Developing Countries' Economies Suffered in '83, World Bank Savs, supra note 3.
American banks active in the international lending markets have drafted their loan agreements to avail themselves of the jurisdiction of American courts in order to gain judgment in the event of default. The recent decision by the Second Circuit Court of Appeals in *Allied Bank International v. Banco Credito* in favor of an American bank in its default action against three government-controlled Costa Rican banks, who were precluded by actions of the Costa Rican government from making debt payments, suggests that American banks bringing actions in United States courts will obtain favorable results should they resort to judicial enforcement of sovereign loan agreements. The decision indicates that foreign law will not control debt obligations payable in the United States in American currency.

This Note will discuss the issues of jurisdiction and justiciability arising in default actions against foreign sovereign debtors. Although the *Allied Bank* decision indicates otherwise, the courts should closely scrutinize the institutional and foreign policy aspects of cases brought against sovereign debtors. Given the complexity of the international debt crisis, with its enormous foreign policy and domestic economic implications, the courts are presently not the proper forum in which to resolve the debt crisis. Instead, the problem should be comprehensively addressed in the political arena. Explicit policy directives of the political branches could conceivably provide guidelines for the courts to follow in adjudicating default actions by American creditors against foreign sovereign debtors.

II. FOREIGN DEBT: THE NATURE OF THE PROBLEM

The spectre of large-scale defaults by foreign sovereign debtors has never loomed so prominently. The last significant default on foreign sovereign debt, which occurred in the 1930’s, involved primarily bonds held by individuals and institutions. In this decade a significant amount

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2757 F.2d 516 (2d Cir. 1985), on reh’g.

3Id. at 522.

4The issue of justiciability involves the judicially-created act of state doctrine.

5Delineation of explicit guidelines to be provided by the political branches is beyond the scope of this Note. This Note will discuss variables which the political branches should address, and which at present militate against judicial resolution of the debt crisis.

of foreign sovereign debt is in the form of commercial bank lending and therefore has much broader potential impact in the event of widespread defaults.\textsuperscript{13}

From the lenders' side, a default action initiated by a creditor unwilling to reschedule could involve the invocation of the ubiquitous cross-default clauses present in sovereign loan agreements.\textsuperscript{14} The cross-default clause, which prevents a lender from being placed at a disadvantage among the borrower's creditors,\textsuperscript{15} triggers the default clauses in all loan agreements entered into by the troubled borrower.\textsuperscript{16} One default declared by a creditor thus has the possible effect of placing all the debtor's loans in default, conceivably necessitating suits by other creditors to protect their interests.\textsuperscript{17} This could lead to the potentially disastrous consequence of the creditors being forced to write off the loans.\textsuperscript{18}

A suit by a recalcitrant creditor unwilling to renegotiate might in turn lead to declarations of default or outright repudiations by borrowing nations.\textsuperscript{19} Debtor cartels\textsuperscript{20} could result, leading to the cessation of payments by a number of sovereign debtors. The potential conflict between creditor and debtor nations presents a real threat to an increasingly interdependent international banking system as well as to the solvency of a number of American banks.

\textsuperscript{13}If banks are forced to write off defaulted loans, their asset growth, earnings, and capital position would be adversely affected. A severe contraction of available domestic credit could also result. Comment, \textit{International Debt}, supra note 2, at 856-57 n.15. \textit{See also infra} note 18.

\textsuperscript{14}Barnett, Galvis & Gouraige, \textit{supra} note 2, at 113. When the present crisis first arose, it was conjectured that a smaller regional bank with limited international exposure would forego renegotiation of existing debt. This is precisely what occurred in the Allied Bank case, in which only one of the thirty-nine members of the banking syndicate appealed the trial court's decision. This possibility is countered, however, by pressure brought to bear on the smaller banks by members of the banking community with greater international debt exposure.

\textsuperscript{15}Ryan, \textit{supra} note 7, at 95-96.

\textsuperscript{16}Barnett, Galvis & Gouraige, \textit{supra} note 2, at 113.

\textsuperscript{17}\textit{Id.} To date, the cross-default clauses have not been invoked.

\textsuperscript{18}Upon a declared default, bank regulators require the lender either to increase its loan loss reserves or, to the extent not done so already, write off all or a portion of the loan. Clarke & Farrar, \textit{Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers}, 1982 U. Ill. L. Rev. 229, 232 (1982). Given the extensive international exposure of a number of American lending institutions, bank failures could result. \textit{See supra} note 4.

\textsuperscript{19}A country experiencing domestic economic and political difficulties could opt to defy its creditors and cut itself off from bank credit. This would, of course, be costly to the borrower, who would be, at least in the short term, cut off from commercial lenders. Furthermore, other debtor nations, themselves involved in the renegotiation process, have brought pressure on other borrowers not to repudiate.

\textsuperscript{20}It is speculated that upon a default declaration, other borrowing nations would support the defaulting country and default on, or repudiate, their own loans. Recently,
A. The Internationalization of American Banking

Since the late 1960's, American banks have greatly expanded their activities in the international lending markets. In 1967, fifteen American banks had a total of 295 overseas branches and subsidiaries. In a decade, the extension of credit to foreign entities by American commercial banks grew eightfold.

While American banks had previously extended credit primarily to European and other industrialized countries, beginning in the early 1970's the banks began to focus on lesser developed countries, particularly in Latin America. A marked shift from lending to private interests to extending credit to foreign governments and government-controlled entities also ensured. This shift in the nature of foreign lending coincided with the expansion of American banking activity in the virtually unregulated international money markets.

American banks, closely regulated domestically, sought new markets a group of Latin American countries with a combined external debt of $330 billion formed a coalition to negotiate with their creditors. The coalition, called the Cartagena Group, is advocating cooperation while at the same time expressing dissatisfaction with protectionist trade practices in the creditor nations and with their lack of input regarding world economic policies. Debt Crisis Called All But Over, N.Y. Times, Feb. 4, 1985, at 25, col. 4.

Robert Reisner, supra note 1, at 2. In 1970, the total was approximately $50 billion. S. Reserve BULL. A 85 (Tables 14, 15), A 88 (Table 21a) (Dec. 1972). By December, 1981, that total had grown to over $400 billion. 58 FED. RESERVE BULL. A 63 (Table 3, 20) (Jan. 1982).

Robert Reisner, supra note 1, at 2; See Davis, Banker's Casino: Gambling in the $900 Billion Euromarket, Harpers, Feb., 1980, at 43.

Robert Reisner, supra note 1, at 3.

This transformation in the banking industry escaped the notice of the industry's state and federal regulators. Id. at 1.

"[N]o single bank regulatory agency, national or international has either the authority or the responsibility to oversee this market. Until recently, the Federal Reserve and the Comptroller of the Currency did not even have comprehensive statistics on the foreign claims and liabilities of the overseas branches of U.S. banks. The activities of banks outside their own borders fall largely between the cracks of individual national bank regulations." Id. at 1 n.2, citing Staff of Senate Subcomm. on Foreign Economic Policy of the Comm. on Foreign Relations, 95th Cong., 1st Sess., International Debt, the Banks, and U.S. Foreign Policy 2 (Comm. Print) (1977).

Regulation D of the Federal Reserve, which requires all banks to hold 10-22% of funds in reserve against domestic liabilities, is not applicable to foreign branches of American banks. Davis, supra note 24, at 48-49.
in search of higher profits. The drive for higher profits gained momentum as bankers perceived international expansion as vital to the protection of their share of the banking markets. Profits from international operations soon constituted the majority of the total earnings of the largest participating banks.

This global expansion by American banks was fueled by the infusion of capital stemming from the exponential increases in oil prices and the resultant capital surpluses of the oil-producing countries in the 1970's. This capital, often called "Eurodollars" or "petrodollars," was deposited in the overseas branches of American banks and then lent to the lesser developed nations. Faced with the need for capital for economic development as well as for the increased cost of oil, the non-oil-producing developing nations found access to virtually unconditional loans from American commercial banks, who viewed the sovereign borrowers as good credit risks. By the end of 1982, lesser developed nations owed roughly three hundred billion dollars to commercial banks in the industrialized countries.

B. The Debt Crisis

Economic developments during this same period rendered many sovereign debtors incapable of adequately servicing their newly-acquired

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28 This was due in part to the absence of regulatory control over the foreign branches and subsidiaries of American banks. See supra notes 26-27.
29 In retrospect, many bankers assert that they were not so much driving to maximize profits as trying to keep their share of markets in the face of intensified competition. Silk, The Debate About Bailouts, N.Y. Times, Aug. 3, 1984, at 30, col. 1.
30 For example, by 1976 these banks' earnings from international operations comprised the following portions of total profits: Citicorp, 72%; Chase Manhattan, 78%; and Manufacturer's Hanover, 65%. Davis, supra note 24, at 46.
31 Stated simply, a Eurocurrency is any currency deposited outside the country of origin. Because there is no direct regulation of the Euromarket, an exact figure is not available, although it is estimated that funds in the Euromarket total at least $2 trillion. Maidenberg, Eurodollars at Philadelphia, N.Y. Times, May 13, 1985, at 25, col. 1.
32 The competitive forces relating to loans to sovereign debtors were frequently unrelated to the borrower's ability to repay the loan. Such loans were syndicated on the basis of relatively little actual credit information concerning the debtor's financial condition. Clarke & Farrar, supra note 18, at 231. The massive lending to developing nations was thus based on bank resources rather than the debtors' creditworthiness.
33 Barnett, Galvis & Gouraige, supra note 2, at 84. The bankers perceived the lesser developed nations to be excellent credit risks, primarily based on the assumptions that sovereigns cannot become bankrupt and that there was a great likelihood of official relief from the International Monetary Fund and the federal government in the event of a default. Id. at 89.
external debt obligations. A strong American dollar, high interest rates,\textsuperscript{35} budget deficits, and low commodity prices\textsuperscript{36} left many borrowing countries unable to service external debt. Creditors have rescheduled existing loans,\textsuperscript{37} and in some instances have extended additional credit,\textsuperscript{38} although not on the unconditional terms available in the 1970’s.\textsuperscript{39} In renegotiating, the creditors are requiring assurances, similar to those required by the International Monetary Fund, that the debtor nations institute sound domestic economic policies.\textsuperscript{40}

The extent of the sovereign debt crisis goes beyond the fact that actual payment on the original debt obligations has been delayed by rescheduling.\textsuperscript{41} Several countries are presently unable to pay even the interest on their rescheduled obligations.\textsuperscript{42} A second wave of debt crises may be imminent.\textsuperscript{43}

III. JUDICIAL RESOLUTION OF SOVEREIGN DEFAULTS: QUESTIONS OF JURISDICTION AND JUSTICIABILITY

Despite the number of “non-performing” loans, American banks have not utilized the legal system for enforcement of delinquent loan payments by foreign sovereign debtors to any great extent.\textsuperscript{44} Whether the banks will do so in the future remains uncertain. In that event, though, a suit brought against a sovereign debtor would present issues of jurisdiction and justiciability.

A. Sovereign Immunity

In a suit brought against a foreign sovereign, the court must first address the issue of sovereign immunity.\textsuperscript{45} The doctrine of sovereign

\textsuperscript{35}Increases in interest rates added billions of dollars to debt service costs. N.Y. Times, supra note 20, at 30.
\textsuperscript{36}The sharp decline in prices in the commodities markets greatly reduced levels of hard-currency income needed to service external debt obligations.
\textsuperscript{37}See supra notes 5-6 and accompanying text.
\textsuperscript{38}The new loans are generally at higher interest rates over longer periods, thus compounding the debtors’ liquidity problems. See supra note 35.
\textsuperscript{39}See supra notes 32-33 and accompanying text.
\textsuperscript{40}Farnsworth, America’s Hard Line on Aid to Poor Nations, N.Y. Times, Sept. 27, 1984, at 29, col. 1. The International Monetary Fund, a quasi “bank of last resort,” lends money to cash-short countries to pay their international debt obligations, but only if the countries adopt Fund-proposed “austerity programs.” Comment, International Debt, supra note 2, at 869. The programs are aimed at lowering inflation, curtailing imports and wages, cutting social programs, and devaluing currencies.
\textsuperscript{41}See supra notes 5-6.
\textsuperscript{42}See New Crisis Has Begun in International Debt, Banking Experts Warn, Wall St. J., June 8, 1983, at 1, col. 6.
\textsuperscript{43}Comment, International Debt, supra note 2, at 857.
\textsuperscript{44}Prior to 1982, lender banks had not declared a loan in default except in the case of Iranian credits. Reisner, supra note 1, at 6.
\textsuperscript{45}Persinger v. Islamic Republic of Iran, 729 F.2d 835, 838 (D.C. Cir. 1984), on reh’g.
immunity precludes domestic courts from exercising personal jurisdiction over foreign states. Historically, foreign states enjoyed absolute immunity from being sued in American courts. The courts would dismiss actions against foreign sovereigns for lack of jurisdiction.

In this century, as governments increasingly engaged in commercial activities, a substantial number of states abandoned the absolute theory of sovereign immunity in favor of a restrictive theory of immunity. In 1952 the United States, where a unique practice had emerged in which the State Department became the final arbiter on the question of sovereign immunity, adopted the restrictive theory of immunity. Sovereign immunity was recognized with respect to public acts of state, but not with respect to private, or commercial, acts. American courts, upon the advisement (or silence) of the Department of State, could thus exercise jurisdiction in cases arising out of commercial transactions.

In 1976 Congress enacted the Foreign Sovereign Immunities Act (FSIA). The FSIA codified the rule for jurisdiction over foreign sovereigns and their instrumentalities, thus removing the discretion previously exercised by the executive branch. The issue of sovereign immunity became a question of statutory subject matter jurisdiction, the determination of which was vested solely with the courts.

Generally, under the FSIA, foreign states are immune from the jurisdiction of American courts. The Act provides, however, for ex-

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46The doctrine has its roots in the 19th century notion, as set forth by Chief Justice Marshall in The Schooner Exchange v. McFadden, that sovereigns are not presumed without explicit declaration to have opened their tribunals to suits against other sovereigns. 11 U.S. (7 Cranch) 116, 146 (1812).


49See Republic of Mexico v. Hoffman, 324 U.S. 30 (1945); Ex parte Republic of Peru, 318 U.S. 578 (1943); see also Isbrandtsen Tankers, Inc. v. President of India, 446 F.2d 1198 (2d Cir.), cert. denied, 404 U.S. 985 (1971) (if State Department suggested immunity judiciary would not interfere).

50In the famous "Tate Letter," written by the Acting Legal Advisor of the Department of State to the Attorney General, it was indicated that the Department of State would henceforth follow the restrictive theory of sovereign immunity in its consideration of requests by foreign governments for a grant of sovereign immunity. The letter stated that according to the restrictive theory, the immunity of the sovereign is recognized with regard to public (jure imperio) acts of state, but not with respect to private acts (jure gestionis). 26 DEPT. OF STATE BULL. 984 (1952).

51Id. The private activities discussed in the Tate Letter were acts commercial in nature, or acts which an individual might engage in for profit. See, e.g., Texas Trading & Milling Corp. v. Federal Rep. of Nigeria, 647 F.2d 300, 309 (2d Cir. 1981) (if activity one in which a private party could engage, sovereign not entitled to immunity).

5228 U.S.C. §§ 1330; 1332(a)(2)-(4); 1391(f); 1441(d); and 1602-1611 (1982).


54Id. at § 1604.
ceptions to jurisdictional immunity, and has adopted the restrictive theory of immunity. In addressing the question of whether a sovereign act should be deemed a commercial activity and thus subject to the court’s jurisdiction, the courts are instructed to look at the nature, rather than the purpose, of the activity in question.

The FSIA expressly provides for jurisdiction in many cases that would not have been legitimate before its enactment. Prior to passage of the Act, at least one court had expressed the view that sovereign loans were public, rather than commercial, acts. Under the FSIA, the courts will be able to assume subject matter jurisdiction in default actions against foreign sovereigns who have executed loan agreements with American commercial banks. As stated, such loan agreements generally contain express waivers of sovereign immunity. Even absent such a waiver, the legislative history of the FSIA indicates that borrowing by foreign sovereigns should be deemed a commercial activity, permitting a court to exercise jurisdiction.

B. Act of State Doctrine

In a default action brought against a foreign sovereign debtor, a court with proper statutory jurisdiction may nevertheless decline to address the merits of the case by invoking the judicially-created act of state doctrine, which was unaffected by the enactment of the FSIA. The act of state doctrine represents an exception to the general rule that courts of the United States with appropriate jurisdiction will decide cases by choosing the rules appropriate for decision from among the various sources of law. Abstention on act of state grounds has been analogized

55 Id. at §§ 1605-07.
56 See Puggerio v. Compania Peruana De Vapores, 639 F.2d 872 (2d Cir. 1981) (important goal of FSIA was codification of restrictive theory of immunity).
58 Crockett, supra note 47, at 1042.
60 See supra note 7. Pursuant to 28 U.S.C. § 1605(a)(1), a foreign sovereign is not immune when it has waived its immunity either explicitly or by implication.
to the posture taken with respect to political questions.\textsuperscript{64}

Arising in conjunction with the doctrine of sovereign immunity,\textsuperscript{65} although itself not jurisdictional,\textsuperscript{66} the act of state doctrine reflects the reluctance of the courts to pass judgment on the actions of foreign sovereigns.\textsuperscript{67} The doctrine had its historical roots in the "highest notions of comity."\textsuperscript{68} Similar to the absolute immunity enjoyed by foreign sovereigns, the act of state doctrine created a presumption of non-justiciability in addressing the legal validity of acts of foreign sovereigns.\textsuperscript{69}

In \textit{Banco Nacional de Cuba v. Sabbatino},\textsuperscript{70} the seminal contemporary United States Supreme Court case involving the act of state doctrine, the Court found the doctrine to be rooted not in notions of international comity but in the separation of powers in the federal government.\textsuperscript{71} The Court was faced with a claim arising from an action of the Cuban government that resulted in the expropriation of American property.\textsuperscript{72} Declining to pass on the legality of the Cuban act of state, the Court declared that it would not inquire into the validity of the public acts of a foreign sovereign committed within its own territory.\textsuperscript{73}

The Court stated that while the text of the Constitution does not require the act of state doctrine,\textsuperscript{74} the doctrine has " 'constitutional' underpinnings" arising out of the basic relationship between the branches of the federal government,\textsuperscript{75} and "concerns the competency of dissimilar

\textsuperscript{64}See infra note 71.

\textsuperscript{65}406 U.S. at 762. The separate line of cases enunciating both the act of state doctrine and the doctrine of sovereign immunity has a common source in \textit{The Schooner Exchange}, 11 U.S. at 116. Id.

\textsuperscript{66}Act of state is a prudential doctrine designed to avoid judicial action in sensitive areas. International Ass'n of Machinists and Aerospace Workers v. OPEC, 649 F.2d 1354, 1359 (9th Cir. 1981), cert. denied, 454 U.S. 1136 (1982), citing RICAUD v. American Metal Co., 246 U.S. at 309.

\textsuperscript{67}The classic statement of the doctrine was set forth by Chief Justice Fuller in Underhill v. Hernandez, 168 U.S. 250, 252 (1897):

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

\textsuperscript{68}406 U.S. at 762. See also Oetjen v. Central Leather Co., 246 U.S. at 304.

\textsuperscript{69}168 U.S. at 250. See Note, Rehabilitation and Exoneration of the Act of State Doctrine, 12 N.Y.U.J. INT'L. LAW & POLITICS 599 (1977) [hereinafter cited as Note, Rehabilitation].

\textsuperscript{70}376 U.S. 398 (1964).

\textsuperscript{71}Id. at 423. Subsequently, Justice Brennan stated that \textit{Sabbatino} held that the issue of the validity of a foreign act of state in certain circumstances is a "political question" not cognizable in our courts. 406 U.S. at 787-88 (Brennan, J., dissenting). See L. Tribe, \textit{American Constitutional Law}, 76-78 n.5 (1978).

\textsuperscript{72}376 U.S. at 400-01.

\textsuperscript{73}Id. at 428.

\textsuperscript{74}Id. at 423.

\textsuperscript{75}Id. The doctrine's "continuing validity" depends on its capacity to reflect the
institutions to make and implement particular kinds of decisions in the area of international relations.”76 Rather than establishing an “inflexible and all-encompassing rule” regarding judicial application of the act of state doctrine, the Court called for a “balance of relevant considerations” in each case.77

Despite the extensive analysis of the doctrine in that case, Sabbatino has done little to clarify the scope of the act of state doctrine.78 A great deal of confusion continues to surround its application.79 The courts have been inconsistent in their interpretation and application of the doctrine, due in part to uncertainty as to the courts’ relationship to the political branches and as to the appropriate weight to be accorded to the various interests involved in the litigation.80 The type of balancing dictated by Sabbatino81 requires the courts to address a number of factors in deciding whether to invoke the act of state doctrine. The principal factors to be considered include whether the applicable principles of international law are ambiguous in nature, whether the challenged governmental conduct was public rather than commercial in nature, whether the purpose of the act of state was to serve an integral governmental function, and whether the executive branch has addressed the validity of the act in question.82

While the FSIA instructs the courts to look only at the nature of the foreign state’s action,83 act of state doctrine analysis involves addressing the underlying purpose of the questioned conduct. A distinction has emerged between public and commercial purposes of the governmental act at issue, centering on whether the act constitutes an exercise of the state’s sovereignty in addressing public concerns.84 Where a sovereign has acted in a “public” capacity in addressing national concerns, courts have invoked the act of state doctrine in declining to adjudicate the legal validity of the sovereign’s conduct.85

proper distribution of functions between the judicial and political branches on matters bearing upon foreign affairs. Id. at 427-28.

76 376 U.S. at 423.
77 Id. at 428.
78 Crockett, supra note 47, at 1055.
79 Id.
81 “The balancing of interests, recognized as appropriate by Sabbatino, requires a careful examination of the facts in each case and of the position, if any, taken by the political branches of government.” 406 U.S. at 774 (Powell, J., concurring).
82 Texas Trading, 647 F.2d at 316 n. 38.
83 International Ass’n of Machinists and Aerospace Workers v. OPEC, 649 F.2d at 1360. See also supra note 57 and accompanying text.
84 649 F.2d at 1360 (when state qua state acts in public interest, its sovereignty is asserted).
85 See id. at 1361; Hunt v. Mobil Oil Corp., 550 F.2d 68, 73 (2d Cir.), cert. denied,
In a default action against a foreign sovereign debtor, there may be two sovereign acts involved, as was the case in the Allied Bank\(^8\) litigation. The first act would be the contracting of a loan obligation with a syndicate of commercial banks. This act clearly would have been undertaken for a commercial purpose.

The second governmental act may be the exercise of a national policy affecting the servicing of external debt obligations. A policy constricting or precluding debt servicing in response to an economic crisis would be undertaken for the purpose of regulating the sovereign’s domestic economy. The sovereign would be acting in a “public” capacity in addressing national economic concerns.\(^8\)

Actions affecting a sovereign’s economy are likely to have a strong bearing on foreign affairs.\(^8\) Judicial review of such public acts of state could result in the worsening of United States relations with the sovereign as well as embarrassment of the political branches in their conduct of foreign relations.\(^9\) Invocation of the act of state doctrine would alleviate the necessity of the court’s determining the legal validity of a public sovereign act undertaken with the purpose of serving an integral governmental function. Such was the reasoning of the district court in Allied Bank,\(^9\) although its decision was ultimately reversed on appeal.\(^9\)

IV. Allied Bank International v. Banco Credito

Allied Bank International v. Banco Credito\(^9\) represents the first case pressed to judgment since the onset of the foreign sovereign debt crisis.\(^9\) The case is particularly significant given the paucity of litigation involving the question of default on sovereign loan obligations.\(^9\) Its significance is increased by the fact that the majority of cases involving the act of state doctrine are decided by the Second Circuit Court of Appeals\(^5\) and because many of the sovereign loan agreements, syndicated by New York banks, contain provision for payment in New York.


\(^7\)757 F.2d 516.

\(^8\)See supra notes 84-85 and accompanying text.

\(^9\)Note, Judicial Balancing, supra note 85, at 340.

\(^5\)See 406 U.S. at 765.


\(^9\)Allied Bank, 757 F.2d at 523.

\(^7\)757 F.2d 516 (2d Cir. 1985).


\(^9\)See supra note 44 and accompanying text.

\(^9\)Note, Rehabilitation, supra note 69, at 637.
The action96 was brought originally by the agent bank for a syndicate of thirty-nine banks97 against three Costa Rican banks owned by the Republic of Costa Rica and subject to the control of the Central Bank of Costa Rica. In 1976 the three defendant Costa Rican banks executed a series of promissory notes payable to the syndicate banks in United States currency in New York. Required payments on the notes, due every six months commencing July 1, 1978, through July, 1983, were made on schedule until 1981.98

In that year the Costa Rican government, in response to a serious economic crisis, imposed restrictions upon foreign exchange transactions. One such restriction required approval by the Central Bank of Costa Rica of any foreign exchange transactions by Costa Rican banks. On July 2, 1981, defendant Banco Cartago applied to the Central Bank for authorization to make its payment due on July 1 to the syndicate banks.99

The following month the Central Bank's Board of Directors passed a resolution prohibiting public sector entities such as the defendant banks from paying any interest or principal denominated in foreign currency on debts to foreign creditors. On November 6, 1981, the President and Ministry of Finance published a decree preventing any institution in Costa Rica from making external debt payments without prior approval of the Central Bank in consultation with the Ministry of Finance. Three days later the Central Bank denied Banco Cartago's pending application for foreign exchange.100

Each of the defendant banks was subsequently notified that it would not be permitted to make external debt payments pending resolution of the entire Costa Rican external debt situation. Further payments on the promissory notes were thus effectively blocked. Allied Bank, on behalf of the other syndicate banks, filed suit in the United States District Court for the Southern District of New York to invoke the applicable acceleration clauses in the loan agreements and to recover the balances101 with accrued interest.102

The district court concluded that the act of state doctrine, raised by the defendants in opposition to Allied's motion for summary judg-

97Two of the named plaintiffs were American Fletcher National Bank of Indianapolis and American Fletcher (Suisse) A.G. 566 F. Supp. at 1440.
98Id. at 1442.
99Id.
100Id.
101For the three defendant banks, the total unpaid principal balances totalled approximately $4.5 million. Id.
102566 F. Supp. at 1442.
ment,\textsuperscript{103} dictated the denial of Allied's motion.\textsuperscript{104} In its analysis, the court readily disposed of the sovereign immunity issue raised by the defendants. The court found that it was quite clear that the execution of the promissory notes was a commercial activity within the meaning of the FSIA.\textsuperscript{105}

Conceding that the action was premised on a commercial activity within the meaning of the statute, the court then stated that "a different question arises by virtue of the fact that the payment of the notes was prevented by certain directives of the Central Bank of Costa Rica, and of the President and Ministry of Finance of that country."\textsuperscript{106} The crux of that question was whether the governmental acts preventing payment of the notes fell within the act of state doctrine.\textsuperscript{107}

The court noted that the act of state doctrine, designed to avoid judicial action which would impinge upon the foreign relations of the United States, may prevent recovery even where the defense of sovereign immunity does not apply.\textsuperscript{108} To the court, the crucial factor was that the conduct of the Costa Rican government which prevented payment of the notes, undertaken in response to a serious national economic crisis,\textsuperscript{109} was public, rather than commercial, in nature.\textsuperscript{110} There was no doubt either that the actions of the Costa Rican government were intended to serve a public purpose or that the actions were an exercise of a governmental function. The court concluded that:

A judgment in favor of Allied in this case would constitute a judicial determination that defendants must make payments contrary to the directives of their government. This puts the judicial branch of the United States at odds with policies laid down by a foreign government on an issue deemed by that government to be of central importance. Such an act by this court risks embarrassment to the relations between the executive branch of the United States and the government of Costa Rica.\textsuperscript{111}

While the action was still pending before the district court, the parties began to negotiate a rescheduling of the defendants' loan obli-

\textsuperscript{103}There was no question that the defendant banks had defaulted on the debts due to Allied and the other syndicate banks. \textit{Id.}

\textsuperscript{104}566 F. Supp. at 1444.

\textsuperscript{105}Id. at 1443.

\textsuperscript{106}Id. (emphasis in original).

\textsuperscript{107}Id.

\textsuperscript{108}Id.

\textsuperscript{109}Id. "[T]hese actions were of the type which some governments undertake to try to assist in such a crisis — i.e., restrictions upon foreign currency transactions." \textit{Id.}

\textsuperscript{110}566 F. Supp. at 1443.

\textsuperscript{111}Id. at 1444.
gations. In July, 1983, the suit was dismissed by agreement of the parties. In September the defendants, the Central Bank, and the Republic of Costa Rica signed a refinancing agreement. One of the syndicate banks did not accept the new agreement, and Allied appealed on its behalf. The refinancing nevertheless went into effect and the Costa Rican banks made payments to the other members of the syndicate.

The Second Circuit Court of Appeals reversed both the district court’s dismissal of the cause and the denial of Allied’s motion for summary judgment. The court also vacated its earlier decision which had affirmed the district court. Finding the act of state doctrine to be inapplicable, the Second Circuit remanded to the district court for entry of summary judgment in favor of Allied.

In its previous decision affirming the district court, the Second Circuit had not addressed the question of whether the act of state doctrine applied, but had instead concluded that principles of comity compelled it to recognize as valid the Costa Rican directives which prevented payment of the loan obligations. The court had determined that the actions of the Costa Rican government which precipitated the default “were fully consistent with the law and policy of the United States.” Its interpretation of United States policy arose primarily from the court’s belief that the legislative and executive branches of the American government had fully supported Costa Rica’s actions and all of the economic ramifications.

On rehearing, the executive branch joined the litigation as amicus curiae and disputed that reasoning. In its brief the government expressed its support of the debt resolution procedure of the International Monetary Fund that encourages cooperative adjustment of international debt problems. The government explained that the procedure is grounded in the understanding that while the parties may agree to renegotiate conditions of payment, the underlying obligations remain valid and enforceable. The government contended that Costa Rica’s attempted unilateral re-structuring of private obligations was inconsistent with this system of

757 F.2d at 519.
Fidelity Union Trust Company of New Jersey was the only creditor who refused to participate in the restructuring. Id.
757 F.2d at 519.
Id. at 518.
The earlier decision, dated April 23, 1984, was reported in the advance sheets; however, the Second Circuit, upon granting rehearing, vacated the opinion, which does not appear in the bound volume of the Federal Reporter. See Allied Bank Int’l v. Banco Credito, 733 F.2d 23 (2d Cir. 1984).
757 F.2d at 518.
Id. at 519.
Id.
Id.
international cooperation and negotiation and thus inconsistent with United States policy.\footnote{Id.}

The government further explained that its position on private international debt was not inconsistent with either the executive branch’s willingness to restructure Costa Rica’s intergovernmental loan obligations or with the continued approval by Congress of foreign aid to that economically distressed Central American country.\footnote{Id. at 520.} The court, stating that its previous conclusion that the Costa Rican decrees were consistent with United States policy was premised on those two circumstances, expressed its belief that, in light of the government’s elucidation of its position, its earlier interpretation of United States policy had been wrong.\footnote{Id.}

The court nevertheless addressed the issue of the act of state doctrine which, if applicable, would preclude judicial examination of the Costa Rican decrees.\footnote{Id. (citing Banco Nacional de Cuba v. Chemical Bank, 658 F.2d 903, 908 (2d Cir. 1981) and Republic of Iraq v. First Nat’l. City Bank, 353 F.2d 47, 51 (2d Cir. 1965), cert. denied, 382 U.S. 1027 (1966)).} The court stated that it “has always been clear” that the doctrine does not bar inquiry by the courts into the validity of extraterritorial takings.\footnote{757 F.2d at 521.} Because the court was not prevented from inquiring into the validity of an attempted extraterritorial confiscation, pursuant to the territorial limitation on the act of state doctrine, it determined that its decision depended “on the situs of the property at the time of the purported taking.”\footnote{Id. at 521 n.3.}

The court concluded that because the situs of the property, Allied’s right to receive payment in accordance with the loan agreements, was in the United States, the act of state doctrine was not applicable.\footnote{Id. at 522.} The court explained that the situs of a debt for act of state purposes depends in large part on whether the purported taking can be said to have “come to complete fruition within the dominion of the (foreign) government.”\footnote{Id. (citing Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 715-16 (5th Cir.), cert. denied, 393 U.S. 924 (1968)).} Because Costa Rica could not wholly extinguish the defendants’ obligation to timely pay United States dollars to Allied in New York, the situs of the debt was not Costa Rica.\footnote{757 F.2d at 521.}
The court further stated that "[t]he same result obtains under ordinary situs analysis."130 In support of that conclusion, the court set forth policy reasons focusing on United States interests. These interests included maintaining New York as one of the foremost commercial centers in the world and as the international clearing center of United States dollars and ensuring that creditors entitled to payment under contracts subject to the jurisdiction of the United States may assume that, except under the most extraordinary circumstances, their rights will be determined in accordance with recognized principles of contract law.131

The court contrasted those interests to Costa Rica's. While recognizing Costa Rica's legitimate concern in overseeing the debt situation of state-owned banks and in maintaining a stable economy, it determined Costa Rica's interest in the contracts at issue to be limited to the extent to which it could unilaterally alter the payment terms.132 Under either analysis, the situs of the debt was the United States, not Costa Rica; therefore, the act of state doctrine was inapplicable.133

Declaring that it had "come full circle to reassess whether we should give effect to the Costa Rican directives," the court determined that it should not.134 It could do so only if the Costa Rican acts, which fell outside the act of state doctrine because they purported to have extraterritorial effects, were consistent with the law and policy of the United States.135 The court found the Costa Rican acts to be inconsistent with the orderly resolution of international debt problems and inimical to the interests of the United States, a major source of private international credit. Recognition of the directives would also be counter to principles of contract law.136 Because the directives were inconsistent with the law and policy of the United States, the court refused to hold that the governmental acts excused the obligations of the Costa Rican banks.137

Before discussing the implications of the Allied Bank litigation, mention should be made of another default case arising out of an almost identical fact situation and filed in the same district court. In Libra Bank v. Banco Nacional de Costa Rica,138 the defendant was prevented

130Id.
131Id. at 521-22.
132Id. at 522.
133Id.
134Id.
135Id. (citing United States v. Belmont, 301 U.S. 324, 332-33 (1937); Banco Nacional, 658 F.2d at 908-09; Republic of Iraq, 353 F.2d at 51).
136757 F.2d at 522.
137Id.
138570 F. Supp. 870 (S.D.N.Y. 1983). The opinion, in which the court reached a conclusion opposite to that of the district court in Allied Bank, was handed down only a matter of days after that decision. See Note, Act of State: Foreign Defaults in Domestic Courts, 25 HARV. INT'L L.J. 195 (1984) [hereinafter cited as Note, Act of State].
by the 1981 directives of the Costa Rican government from making loan payments to the plaintiff banking syndicate. Rejecting the defendant's contention that the governmental directives constituted a defense under the act of state doctrine, the court granted the plaintiffs' motion for summary judgment.139

The court recognized what it termed the "territorial corollary" to the act of state doctrine as an important limitation on the preclusive scope of the doctrine.140 "Unless the expropriation occurs within the foreign state, this court is free to inquire into the validity of the acts of the foreign nation."141 The court held that the situs of the debt was in New York at the time of the attempted confiscation142 by the Costa Rican government, thereby making the act of state doctrine inapplicable.143

Because the act of state doctrine did not apply, the court was free to examine the validity of the Costa Rican decrees and would give effect to those acts of state only if they were consistent with the policy and law of the United States.144 The court then further held that it would not give effect to the decrees "since a foreign state's effective confiscation of property, without compensation, is repugnant to the Constitution and laws of this nation."145 While "not unmindful that the effect of its judgment is to reverse the Costa Rican decrees,"146 the court reasoned that because its judgment was unlikely to vex the peace of nations, it was not necessary to defer to the foreign affairs competence of the political branches.147

In support of its reasoning, the court noted that the underlying notion embodied in the territorial limitation on the act of state doctrine is that courts will vex this country's relations with foreign governments only when they act to frustrate the foreign nation's reasonable expectations of dominion over the property at issue.148 By limiting its analysis to the territorial limitation on the act of state doctrine, with the resultant assumption that the judgment would not hinder the conduct of foreign

139570 F. Supp. at 896.
140Id. at 877. "Under Sabbatino's formulation, the act of state doctrine forecloses judicial inquiry into the validity of foreign seizures only when there is 'a taking of property within its own territory by a foreign sovereign government.'" Id. (citing Sabbatino, 376 U.S. at 428 (court's emphasis)).
141570 F. Supp. at 877.
142Costa Rica's attempt to extinguish the plaintiffs' legal right to repayment of the debt was deemed by the court to be an attempted confiscation of property. Id. at 882.
143570 F. Supp. at 882.
144Id. (citing Republic of Iraq, 353 F.2d at 51).
145570 F. Supp. at 882.
146Id.
147Id.
148Id. at 883-84. See United Bank, Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868, 875 (2d Cir. 1976).
relations, the court failed to address the possibility of embarrassing the political branches of the government which, as recognized by the Second Circuit in Allied Bank, had apparently taken a favorable position toward the plight of Costa Rica in its economic crisis. The court accorded little weight to the public purpose for which the Costa Rican government had acted, the crucial factor in the lower court’s determination in Allied Bank. The conflicting district court decisions in Libra Bank and Allied Bank thus exemplify the confusion surrounding judicial application of the act of state doctrine.

The Second Circuit’s decision in Allied Bank would appear to create a broadly applicable precedent for any default action involving sovereign loan obligations payable in American currency in the United States. The circumstances presented in that case, involving a governmental act intended to regulate foreign exchange transactions in the face of a severe economic crisis and a good faith attempt to renegotiate the affected loan obligations, could arguably be distinguished from circumstances in which a foreign sovereign engaged in an outright repudiation of its debt obligations. It must be presumed, however, that regardless of the underlying purpose of a sovereign debtor’s act resulting in a default, the act would not be given effect in American courts.

Given the far-reaching foreign policy and domestic economic ramifications of the current debt crisis, the competence of the courts to effect an orderly resolution of the debt crisis is called into question. The Second Circuit was cognizant of the position taken by the political branches vis-à-vis Costa Rica in ruling in the defendant banks’ favor on grounds of comity in its original decision. Faced with the government’s elucidation of its position, on rehearing the court, candidly admitting it had wrongly interpreted the “political signals” of the political branches, understandably had little choice but to find the Costa Rican acts of state to be inconsistent with United States law and policy.

It is interesting to hypothesize what the executive branch’s position

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149757 F.2d at 519.
150566 F. Supp. at 1443-44.
151See supra note 80 and accompanying text.
152757 F.2d 516.
153The Second Circuit did allude to the possibility that “under the most extraordinary circumstances” a United States court would not apply American substantive law as its rule of decision. Id. at 521-22. It is uncertain what those extraordinary circumstances might entail.
154One commentator has concluded that the lower federal courts, absent a clear statement by the Supreme Court regarding the constitutional underpinnings of the act of state doctrine, are increasingly drawn into judging economic disputes beyond their constitutional competence. Kleinman, supra note 80, at 116.
155757 F.2d at 519.
156Id. at 522.
157In act of state cases, any position articulated by the executive branch is not controlling
would be in the event, however unlikely, that an American creditor unwilling to renegotiate with a major sovereign debtor brought a default action in a United States court. The loan obligations of the Allied Bank defendants were de minimis in comparison with the huge external debt obligations of the major Latin American countries. In light of the position presented to the appellate court in Allied Bank, it would be logically consistent to assume that the executive branch would view any attempted unilateral alteration of external debt obligations to be inconsistent with the accepted debt resolution procedure and therefore inconsistent with American policy.

Regardless of the position of the executive branch, however, the ultimate decision as to the justiciability of the merits of a default action rests solely with the courts. Act of state doctrine concerns include addressing the institutional limitations of the judiciary in adjudicating politically sensitive international disputes and the possibility of affronting foreign states. Yet limiting the scope of that doctrine under the territoriality corollary will allow the courts to address the merits of any case in which debt payments due in this country are prevented by a public act of the sovereign debtor.

V. Execution of a Default Judgment

In the event that a commercial bank gains a judgment in a default action, the problem of executing on the judgment would remain. Reciprocal enforcement of the judgment in a court sitting in the country against which the judgment was entered would presumably be virtually impossible. The possibility of actual recovery on such a judgment would hinge on the ability of the plaintiff to attach the defendant’s assets located within the United States.

Because it is likely that a creditor’s declaration of default, or even the threat of such action, would prompt the sovereign borrower to

on the court; whether to apply the doctrine is always a judicial question. See id. at 521 n.2. In First National City Bank, 406 U.S. at 759, six members of the Court rejected the adoption of the so-called “Bernstein exception” to the doctrine, which purported to allow the executive branch to offer an advisement as to the doctrine’s applicability. “The task of defining the contours of a political question such as the act of state doctrine is exclusively the function of this Court.” Id. at 790 (Brennan, J., dissenting).

The unpaid principal balances totalled approximately $4.5 million. 566 F. Supp. at 1442.

See 757 F.2d at 519-20.

Id. at 519.

See supra note 157.

See International Ass’n of Machinists and Aerospace Workers, 649 F.2d at 1360.

One commentator has suggested this to be a formalistic limitation on the scope of the doctrine. See Note, Act of State, supra note 138, at 200.

See Nichols, supra note 59, at 258.

Peru, worried that its assets deposited in American banks might be vulnerable, has
remove its assets in the United States in order to avoid attachment, the creditor would most likely seek a prejudgment attachment of those assets in an attempt to prevent removal. This scenario was presented in the *Libra Bank* 166 case. Libra Bank had attached assets in the defendant’s New York bank accounts under a state court attachment obtained prior to removal of the case to federal court. 167 The district court rescinded that attachment order, finding that the defendant had not waived its immunity to prejudgment attachment. 168

On interlocutory appeal the decision was reversed, 169 the Second Circuit Court of Appeals holding that Costa Rica had waived any objection to prejudgment attachment. 170 When the plaintiffs subsequently sought to reattach the assets, they discovered the defendant had transferred all of its assets out of New York. 171 Rejecting the plaintiff’s request, premised on the defendant’s alleged misrepresentations that it could not transfer its assets, for an extraordinary writ to compel the plaintiffs to return the assets, the district court noted that the plaintiffs had failed to show that the defendant had deceived the court into vacating the attachment. The court also noted the plaintiffs could have sought a restraining order to prevent the defendant from transferring its assets. 172

The FSIA provides exceptions 173 to the general provision in the Act that the property of a foreign state located in the United States will be immune from attachment and execution. 174 A foreign sovereign’s property used for a commercial activity 175 in this country will not be immune from attachment if the foreign state has waived its immunity. 176 The loan agreements executed by sovereign debtors often contain clauses waiving immunity from attachment of the sovereign’s assets located in the United States. 177

Attachment of a foreign sovereign’s assets would have both political

withdrawn its deposits from American banks to which it is indebted and has moved the assets into French banks. Kristof, supra note 20, at 38, col. 1.

166 570 F. Supp. at 870.

167 Id. at 885.

168 Id.

169 Libra Bank Ltd. v. Banco Nacional de Costa Rica, 676 F.2d 47, 48 (2d Cir. 1982).


171 570 F. Supp. at 585.

172 Id.


174 Id. at § 1609.

175 This language raises a question in the context of a default case, as normally there would be no property specifically used by the foreign state in connection with a borrowing of money. Ryan, supra note 7, at 126.


177 Nichols, supra note 59, at 258. Such clauses waive immunity as to all property rather than merely commercial property. *Id.*
and economic implications. Politically, the attachment of a sovereign debtor’s assets may have an adverse effect on the United States’ relations with that country. The potentially adverse effect could be increased if the executive branch had been active in negotiations with that country to resolve its difficulties in servicing its external debt obligations.

In relation to the American economy, the removal of substantial amounts of foreign central bank funds would have an immediate and adverse effect on both the United States balance of payments and the strength of the American dollar.\textsuperscript{178} Further, the removal of foreign reserves invested in United States government securities could seriously affect the United States government’s ability to manage the public debt.\textsuperscript{179} If American courts were to allow such attachments, foreign central banks, including those not involved in litigation, might remove their assets to more secure jurisdictions.

A narrow interpretation by the courts of the statutory exceptions to immunity from attachment of foreign sovereign assets has been advocated to prevent disruptions in the international monetary system.\textsuperscript{180} Some bankers feel it is unlikely a creditor would seek an attachment because pressure would be exerted by the banking community.\textsuperscript{181} Nevertheless, a creditor armed with an agreement containing a waiver clause would be able to invoke the power of a court to prevent a defaulting sovereign from removing its assets.

VI. LOOKING TO THE FUTURE

Although the severity of the foreign sovereign debt crisis has subsided somewhat since 1982,\textsuperscript{182} the spectre of large-scale defaults continues to loom on the horizon. A look at the primary actors facing the problem will raise the issues they must confront in seeking a long-term resolution of the crisis. In the final analysis, the courts are not now the proper forum in which to resolve this complex problem which could have devastating consequences for the American banking system as well as the international monetary system.

A. The Banks

American commercial banks have not sought judicial resolution of


\textsuperscript{179}Id. "At year end 1981, foreign official institutions held about $169.6 trillion in U.S. bank liabilities, U.S. government obligations, and U.S. corporate stock and bonds." Id. (citing 68 \textsc{Fed. Reserve Bull.} A58 (1982)).


\textsuperscript{181}Kristof, supra note 20, at 38, col. 2.

\textsuperscript{182}See supra note 5-6.
the sovereign debt problem to any great extent. This is due to a number of factors, including the extreme difficulty of executing on a judgment, the extent of banks’ exposure in the international markets, banks’ desire to transact future business with presently troubled debtors, and the desire for a continued perception by foreign investors that the United States is a “safe” jurisdiction in which to invest central bank funds.

These factors are in part responsible for the reluctance of banks to seek judicial enforcement of non-performing loans. Banks have preferred to renegotiate existing loan obligations, and in some instances extend additional credit, on an ad hoc basis. Their preference for renegotiation is reinforced by the willingness of sovereign debtors to enter into such talks.

Willingness on the part of sovereign borrowers to come to the bargaining table rather than repudiate their debts is a reflection of recent changes in the global economic and political order. These changes include the growing interdependence of nations, the existence of supranational banking institutions such as the International Monetary Fund (IMF) and the World Bank, the high level of intergovernmental debt, and the fact that the creditors are now predominantly commercial banks that can cut off even short-term trade financing. The factors compelling bargaining are economic and political rather than legal.

One commentator has suggested that sovereign borrowers’ debt servicing difficulties, at least in the intergovernmental context, should be viewed as development problems rather than as collection problems. Sustained economic growth by the lesser developed countries is unquestionably in the best interests of the American commercial banks. Yet while this perception of the debt servicing problem is a reflection of the interdependence nature of the global economic order, their own viability presumably remains the paramount interest of the affected American banks.

The banks have taken the steps necessary to invoke the jurisdiction of American courts for enforcement of sovereign loan agreements. The result of the Allied Bank litigation suggests this to be a viable

183Reisner, supra note 1, at 6.
184See supra note 4. Because it is difficult for the major creditors to reduce their exposure in Latin America, they will most likely stretch their loan commitments at least into the remainder of this century. Comment, International Debt, supra note 2, at 856-57 n.15.
185See supra notes 178-79 and accompanying text.
186Clarke & Farrar, supra note 18, at 262-63.
187Id.
188Comment, International Debt, supra note 2, at 884-85.
189See supra note 7 and accompanying text.
190757 F.2d 516.
alternative. Such a victory may, however, be a hollow one, given the difficulty in executing on a judgment and the likelihood of balance sheet reductions in the wake of the declared default.

The prospect of further litigation depends on the desire of the banks to initiate such action. Pressures brought to bear from within the banking community on smaller creditors, at comparatively less risk in declaring a default, lessen the likelihood of an increase in litigation. The major creditors, with a greater stake in the outcome of the sovereign debt crisis, have thus far opted for renegotiation of the loan obligations. The possibility of future litigation depends on the banks, who may well continue to pursue other nonlitigious alternatives.  

B. The Executive Branch

The executive branch must consider a number of variables in its policy formulation in response to the problem of foreign sovereign debt owed to American commercial banks. Domestically, it must be concerned with the solvency of the banks, which would be jeopardized in the event of a large-scale default. The banks presently comprise a system "of-extended" and "fragile." Some experts contend that the Federal Reserve could assist the banks in adjusting to a debt moratorium. That contention is speculative, given the percentage of bank capital represented by loans to foreign sovereigns. Capital losses would significantly reduce both bank earnings and shareholders' equity and most likely would result in a contraction of available domestic credit. It has also been suggested that the Federal Reserve Board could alleviate the squeeze on banks forced to write off loans by liberalizing its reserve requirements.

Also of domestic economic importance is the United States' trade balance. In order to meet debt repayment schedules, many lesser developed countries have significantly reduced purchases of imports from the industrialized countries, including the United States. In 1982 Amer-

191 Recently, Citicorp secured $900 million worth of insurance against losses on loans to four Latin American nations and the Philippines. According to a 10-Q form filed with the Securities and Exchange Commission, the insurance, believed to be the first acquired by an American banking organization, "protects against the risk of major losses from prolonged delays in receiving funds from a country because of a government's inability or refusal to make the foreign exchange (payment) available." The Indianapolis Star, Sept. 8, 1984, at 33, col. 1.

192 Silk, supra note 29, at 30.

193 How an LDC Default Would Hit the U.S. Economy, BUSINESS WEEK, Nov. 7, 1983, at 118 [hereinafter cited as LDC Default].

194See supra note 4.

195 LDC Default, supra note 193, at 118.

ican exports to the six largest developing countries fell by thirty percent. Relieving the debt servicing burden on these countries is crucial to their economic development, which in turn is necessary to stimulate the purchase of American exports.

Internationally, the executive branch must maintain relations with countries beset by slumping economies and debt servicing burdens. Declarations of default by American banks could have a direct impact on those relations. Breakdown of political alliances as well as trade relationships may occur. The austerity programs urged by creditors could result in political upheavals, particularly in those countries with fragile democratic systems.

The executive branch must also confront the proposal endorsed by a number of lesser developed countries for a new international economic order. The global approach to the sovereign debt problem favored by some developing countries involves the creation of new international institutions and a large discounting of the debt. The costs of discounting of the debt would be absorbed by the banks and taxpayers of the United States and the other creditor nations.

Generally, the executive branch has taken the position that "[a]ny lasting solution to the debt crisis must center around the commercial banks." It has advocated that the banks roll over existing debt and in some cases increase lending. The executive branch has participated, along with the International Monetary Fund and the other creditor nations, in the ad hoc, case-by-case approach utilized thus far in attempting to resolve the debt crisis. Beyond urging debtor nations to provide incentive and commercial opportunities to private enterprise, there has been no apparent comprehensive approach enunciated by the executive branch to effect a long-term resolution of the crisis.

In the event of a large-scale default, some commentators have proposed that direct action could be taken by the executive branch. They suggest that the executive could freeze the defaulting nation’s assets located in the United States and set up a claims settlement at a national level. While this approach might avoid the problem of depletion of the debtor’s assets caused by numerous attachments in individual lawsuits,

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197 Id. A decline in export sales results in the loss of billions of dollars of income and has a negative impact on unemployment rates. Id.
199 Id.
200 Wallis, supra note 34, at 42.
201 Id. at 43.
202 Id.
203 Barnett, Galvis & Gouraige, supra note 2, at 124.
204 Id.
as the President could nullify those attachments, there would be political and economic repercussions if such action were taken.

The executive branch's case-by-case approach has its merits, the foremost being flexibility in dealing with the particular circumstances involved. By virtue of its position taken in the appeal of Allied Bank that unilateral alterations of debt obligations are inconsistent with American policy, the executive branch has apparently given a signal to the courts that it approves of legal enforcement of sovereign loan agreements.

However, the numerous and complex issues presented in sovereign default cases cannot be effectively resolved in the courts. The interests involved in these cases are domestic, including the stability of the banking system and the rising budget and trade deficits, as well as international. The executive branch, with the power to effect a resolution encompassing all of the interests at stake, should take the lead in addressing this crisis with its potentially devastating consequences.

C. Congress

Congress, in codifying the jurisdictional question of sovereign immunity, did not address the act of state doctrine. While recognizing that foreign sovereigns involved in commercial activities cannot evade the jurisdiction of American courts by claiming sovereign immunity, the legislative branch has left the courts to grapple with the question of whether to address the merits of such cases. A clear legislative mandate on the issue of liability in sovereign debt disputes is one alternative to case-by-case determinations.

The Supreme Court in Sabbatino determined that the act of state doctrine precluded a challenge to the validity of the Cuban expropriation. In reaction to that decision, Congress passed the Hickenlooper Amendment to the Foreign Assistance Act of 1961. The amendment directs that cases arising out of foreign expropriations be decided on the merits unless the executive branch intervenes.

This statutory exception to the act of state doctrine has subsequently been construed to apply only to claims of title or other rights to specific

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206 See supra notes 178-79 and accompanying text.
207 757 F.2d 516.
208 Id. at 519-20.
209 See supra note 62 and accompanying text.
210 376 U.S. at 438.
property expropriated abroad.\textsuperscript{213} It represents, nonetheless, an attempt by the legislative branch to address the question of whether American interests harmed by the acts of a foreign sovereign can gain redress in American courts. No analogous action has been taken in response to the current debt crisis to direct the courts on the question of liability for sovereign defaults.

The legislative branch has, however, taken steps to address the debt crisis. In 1983 Congress enacted the International Lending Supervision Act.\textsuperscript{214} The Act, among other provisions, calls for implementation of strengthened domestic and international bank supervisory practices, disclosure by banks of their foreign sovereign debt exposure, and establishment in some instances of special reserves on international loans.\textsuperscript{215}

The legislative history of the Act reveals a recognition by Congress of the problems faced by the developing nations and a desire to work in cooperation with those countries to devise a long-range solution to the debt crisis.\textsuperscript{216} Further legislation could call for the creation of new international institutions responsible for monitoring the stability of the international monetary system. Congress has recognized the need for comprehensive solutions, which cannot be achieved through piecemeal adjudications.

\section*{D. The Courts}

In a default case brought by an American creditor against a foreign sovereign debtor the threshold question of sovereign immunity has been simplified by the enactment of the FSIA. The courts are still faced, however, with the task of resolving the question of whether to address the merits of the case. The decision of whether to invoke the act of state doctrine involves analyzing the issue of deference to the foreign affairs competence of political branches.

The Second Circuit in \textit{Allied Bank} found the act of state doctrine inapplicable because there was no taking of property by Costa Rica within its own territory.\textsuperscript{217} The territorial limitation on the preclusive scope of the act of state doctrine is premised on the notion that the situs of the debt is controlling.\textsuperscript{218} If the taking of a right to repayment cannot be effected within the territory of the sovereign debtor, the act of state doctrine is inapplicable.

\begin{footnotesize}


\textsuperscript{215}Id.

\textsuperscript{216}H.R. REP. No. 98-175, 98th Cong., 1 Sess. 3, \textit{reprinted in} 1983 U.S. CODE CONG. & AD. NEWS 1898, 1904.

\textsuperscript{217}757 F.2d at 522.

\textsuperscript{218}Id. at 521.
\end{footnotesize}
The act of state doctrine, after Sabbatino, involves institutional concerns in making decisions in the area of international relations. The act of state doctrine, after Sabbatino, involves institutional concerns in making decisions in the area of international relations. Inherent in the territorial limitation is the notion that the judgment of the judicial branch will not vex United States relations with foreign nations if the foreign state does not have an expectation of dominion over the property in question. Limiting analysis of the act of state doctrine to the question of dominion leads to the possibility of offense to the sovereignty of the foreign state and conflict with policy initiatives of the political branches of government.

While the act of state doctrine is not mandated by the text of the Constitution, it does have "constitutional underpinnings." It arises out of the basic relationships between branches of government in a system of separation of powers. It concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations. The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere.

The courts are faced with the task of balancing the vital national interests of both the United States and debtor sovereigns. In the context of the foreign debt crisis, the competency of the courts to balance these interests successfully is questionable. As stated by the court in In re Uranium Antitrust Litigation, "[T]he judiciary has little expertise, or perhaps even authority, to evaluate the economic and social policies of a foreign country." Another consideration in the foreign debt crisis is a sensitivity to, as described by the Sabbatino Court, the "practical and ideological goals of the various members of the community of nations." The "basic divergence between the national interests of the capital importing and capital exporting nations" is of major concern in the resolution of

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219376 U.S. at 423.
220Libra Bank, 570 F. Supp. at 883. "The underlying notion embodied in the territorial limitation is the considered judgment of the judicial branch that courts will vex our relations with foreign governments only when they act to frustrate the foreign nation's reasonable expectations of dominion." Id. at 884.
221376 U.S. at 423.
222Id.
224Id. at 1148.
225376 U.S. at 430.
226Id. As suggested by the Court, "no area touches more sensitively on the practical and ideological goals of states." Id.
the foreign debt crisis. The debtor countries are advocating a broader agenda in resolution of the crisis, calling for a "new equilibrium" that would give the capital importing countries greater input in world economic policies, including adjustments in international interest rates.

It has been proposed that the federal courts should adopt a presumption of abstention from examining a foreign government's acts and look to the political branches for guidance. In general, given the current trend of increasing governmental participation in the international marketplace, that proposal is an overstatement. As stated by Justice Powell in First National City Bank v. Banco Nacional de Cuba, the courts should not abdicate their responsibility to address issues arising from transactions involving foreign sovereigns. Because "the courts of the various countries afford the best means for the development of a respected body of international law," there is less hope for such development if all acts of state are relegated to the political branches.

Perception of a more active role for the courts is shared by those who, contrary to the suggestion that the courts adopt a presumption of nonjusticiability, view American courts as "agents of development" of the international legal order. According to this view, the domestic courts have a responsibility to improve the quality of international legal stability and help to overcome institutional deficiencies on a supranational level. The courts should be devoted to the task of reducing international tensions by carrying out judicial duties without assuming a partisan posture.

This position was addressed by the Supreme Court in Sabbatino. The Court stated that the contention presumes decisions of the United States courts "would be accepted as disinterested expressions of sound legal principle." Such acceptance is unlikely in the context of the debt crisis, given the delicate foreign relations aspects. Judgments by American courts in favor of American creditors could intensify conflict between the creditor and debtor nations.

The factors to be addressed by the court in a default action are complex and far-reaching. It is questionable whether the courts are able

227Note, Judicial Balancing, supra note 85, at 352.
228406 U.S. 759.
229Id. at 775 (Powell, J., concurring).
230Id.
232Id.
233Id. at 41.
234376 U.S. at 434-35. Some commentators have questioned whether American courts can behave disinterestedly when applying domestic law to international questions. See, e.g., Kleinman, supra note 80, at 132.
to balance adequately all the interests involved. Judicial balancing is made more difficult by the lack of a contemporary Supreme Court declaration on the act of state doctrine, which might better define the notion of institutional relationships inherent in the doctrine.

VII. CONCLUSION

The historically unprecedented lending by American commercial banks to foreign sovereigns has resulted in a crisis precipitated by the inability of the debtor nations to service adequately their loan obligations. Debt rescheduling has alleviated the crisis in the short term. Participating American banks have sought legal remedies to a minimal extent. It remains uncertain to what extent they will do so in the future.

The terms of the loan agreements give American courts subject matter jurisdiction over default actions. The courts are then faced with the question of justiciability, which requires a balancing of national interests and international relationships. Determination of the justiciability issue involves the competency of the courts to balance these interests effectively. Allied Bank indicates that sovereign debt questions are in fact justiciable, making judicial deference to the political branches unnecessary.

Long-term resolution of the crisis will be achieved through political processes, not by piecemeal adjudications. Recognition of the political and economic interdependence of the members of the international community should lead to multilateral agreements and the creation of new international institutions. Establishment of supranational institutions will involve the difficult task of overcoming perceived threats to national sovereignty. National financial and economic policies are an integral part of the exercise of that sovereignty, making the difficult task of reaching a compromise resolution of the debt crisis a function of political rather than legal processes.

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